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CONTENTS

Volume XXVIII, Number 6, June, 1951

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THE LAWYERS' SIDE OF THE SUITS AGAINST REAL ESTATE BROKERS*

WILLIAM RANN NEWCOMB
Chairman, Unauthorized Practice Committee, Denver Bar Association

It is difficult to speak on behalf of other lawyers because they, themselves, are likely to entertain many different opinions. However, you should not be misled by the occasional lawyer who expresses opposition to the activity on behalf of the bar associations in bringing these suits against real estate brokers. It is clear that the overwhelming majority of lawyers in Denver and in Colorado do support the purposes and the objectives of this litigation. You should also know that Colorado is not alone, and these suits are part of a nationwide movement to clarify and define the proper activities of title companies and real estate brokers.

What Are The Issues In The Suits?

The charge made by some people that we are trying to put real estate brokers out of business is the purest form of unadulterated bunk, for that cannot possibly be the result even if the plaintiffs are 100 per cent successful. We do not challenge the right of brokers to draw every instrument to which they may be a bona fide party—and that includes the listing. We do not challenge the right of any persons to act as their own lawyers in preparing instruments to which they are parties. However, we are challenging the right of brokers and salesmen and title companies to prepare contracts of sale, receipts and options, deeds, leases, notices to vacate, demands for rent or possession, mortgages, promissory notes secured by deeds of trust, and other documents involved in the closing of real estate transactions to which the brokers and salesmen are not parties.

Why Did We Bring Them?

There are three motives behind these suits:

1. *The public interest.* The broker is not qualified by education, training or experience to prepare legal instruments. Although he may pick up a smattering of information as to how to fill in the blanks of a form, no one can reasonably argue that, as a class, he is as well qualified to do these things as a lawyer. Great harm has resulted in many instances to members of the public from improperly prepared contracts and conveyances.

> There is no question but what improperly prepared legal documents make for a great mass of the litigation in the courts of our land. It therefore follows that the preparation of legal documents should be confined to the care of those who are not only skilled by reason of their profession and their experience, but as well, their understanding of the legal significance of all terms employed in the documents.[1]

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* A digest of an address given by Mr. Newcomb before a meeting of the Denver Realty Board on May 2, 1951.

[1] In re George A. Warl, Misc. 51808, Detroit, Michigan.

> Is it only in court or in legal proceedings that danger lies in such evils (unauthorized practice)? On the contrary, the danger there is at a minimum for very little can go wrong in a court where . . . the presiding officer is generally a man of judgment and experience . . . not so in the office . . . Ignorance and stupidity may here create damage which the courts of the land cannot thereafter undo.[2]

The public interest is further involved because a broker is disqualified through his interest, as a businessman, in his commission from attempting to represent both himself and both parties to a transaction. He attempts to serve three masters—himself, the seller, and the buyer. Virtually every lawyer in the state has seen instances of where this inherent conflict in interests has resulted in a disregard of the legal interests of the real parties to a transaction. The broker performs his task when he produces a buyer ready, willing and able to buy. Thereafter, the interests of the purchaser and seller should assume the controlling role.

2. *The interest of the lawyer.* The lawyer normally spends thousands of dollars securing his education. The law requires that he be examined and licensed. No one here today would claim that lawyers should not be licensed or that anyone, regardless of qualifications, should be allowed to practice law in our complex society. Consequently, in protecting his franchise, the lawyer is upholding the laws which exist for the protection of the public. The lawyer is at a competitive disadvantage with the layman who practices law because the layman can solicit business and advertise, whereas the lawyer is forbidden by his ethics from so doing. Therefore, this is not a matter of competing in the market place for legal business, but is a matter of preventing unauthorized practices in the first instance.

3. *The interest of promoting more harmonious relations between brokers and lawyers.* The bickering and back-biting between our two groups which I have witnessed in my eight years of practice, and which has gone on, undoubtedly, for years before that, is a direct result of a lack of clarification as to the proper role of brokers and attorneys in real estate transactions. Just as a lawyer normally has no business advising his client as to values, the broker has no business advising a purchaser that the title is all right because some mortgage company lent money on it five years or six months ago. If these suits result in clarifying and defining the "rules of the game," there is no reason why brokers and attorneys cannot work together in the interests of the public who desire that their real estate transactions shall be handled efficiently, economically, and with due regard to the legal rights of all parties.

WHAT IS THE POSSIBLE OUTCOME OF THEM?

You real estate men will not be put out of business, even if you are restrained from drawing what you call "our contracts." We know that many of these contracts are prepared at night and over weekends when lawyers are not available, but see no legiti-

[2] People v. Alfani, 227 N. Y. 334, 125 N.E. 671 (1919).

mate reason as to why a short delay to provide for a proper contract would unduly hamper your activities. If the deal itself was not over-induced by "high pressure" salesmanship, there would be no withdrawal by the purchaser in this interim period in the vast majority of cases. We think that the importance of these transactions, in any event, justifies mature deliberation and a proper agreement between the parties. We further feel that even though an occasional deal may fall through, to the chagrin of the broker, the total volume of real estate transactions will not vary one iota. We further see a possibility of working out some form of simple receipt wherein the purchaser would evidence his good faith by making a deposit, subject to a contract being written within a very short period of time by an attorney of his selection, or of the seller's selection, satisfactory to both. Of course, by its very nature, such a receipt, if our theory of these suits is correct, could not constitute a contract binding upon the parties.

I wish to emphasize that when the law is clarified as a result of these suits, we will wish to sit down with you and attempt to work out a practical, workable understanding which will not interfere with your legitimate operations and which will be in accord with whatever decision the courts ultimately render. There is historical precedent for this in the Denver banks case where an agreement was made between the Denver Clearing House Banks Association and the Denver Bar Association pending the litigation.

EDITOR'S NOTE: There follows a copy of the complaint against one of the real estate brokers in the suits described above by Mr. Newcomb. The suits against the other two brokers and against the Title Guaranty Company and the Record Abstract and Title Insurance Company are very similar. The complaint is reproduced here in its entirety for the information and enlightenment of our own profession.

IN THE DISTRICT COURT IN AND FOR
THE CITY AND COUNTY OF DENVER
AND STATE OF COLORADO
CIVIL ACTION NO. .... DIV. ....

THE DENVER BAR ASSOCIATION, a corporation; THE COLORADO BAR ASSOCIATION, a corporation; WM. RANN NEWCOMB, as Chairman of the Committee of The Denver Bar Association on Unauthorized Practice; LAWRENCE A. LONG, as Chairman of the Committee of The Colorado Bar Association on Unauthorized Practice; and WM. RANN NEWCOMB and LAWRENCE A. LONG, individually, Plaintiffs vs JOHN F. BRUNO, Defendant	COMPLAINT in Action for Injunction

The plaintiffs allege:

1. That the plaintiff, The Denver Bar Association, and the plaintiff, The Colorado Bar Association, are corporations, other than for pecuniary profit, organized and existing under and by virtue of the laws of the State of Colorado, and that each of them is organized for the following purposes and objects among others: to advance the science of jurisprudence; to promote the administration of justice; to encourage a thorough legal edcuation; and to uphold the honor and dignity of the Bar. That all of the members of each of them are attorneys duly licensed to practice law in the State of Colorado. And that they bring this action on behalf of the public and on behalf of themselves and on behalf of their members.

2. That the plaintiff, Wm. Rann Newcomb, is the Chairman of the Committee of The Denver Bar Association on Unauthorized Practice, and that he brings this action as such Chairman, pursuant to express authorization by said The Denver Bar Association. That the plaintiff, Lawrence A. Long, is the Chairman of the Committee of The Colorado Bar Association on Unauthorized Practice, and that he brings this action as such chairman, pursuant to express authorization by said The Colorado Bar Association. That the said plaintiffs Wm. Rann Newcomb and Lawrence A. Long, also bring this action individually on behalf of themselves and on behalf of all other duly licensed attorneys in the State of Colorado and on behalf of the public.

3. That the defendant is a real estate broker duly licensed as such under the statutes of the State of Colorado. That the defendant now is and for many years last past has been engaged in carrying on in the City and County of Denver, Colorado the business of a real estate broker.

4. That the defendant never has been licensed by the Supreme Court of the State of Colorado to practice law in the State of Colorado and that he therefore cannot lawfully practice law in the State of Colorado, either in his own person or through his agents, servants or employees, whether they be attorneys or not.

5. That for many years last past the defendant has been engaged in the unlawful practice of law in the State of Colorado by preparing for persons other than himself, as a practice and in numerous transactions, either in his own person or through his agents, servants and employees, instruments relating to and affecting real estate and the title to real estate, including deeds conveying real estate, deeds of trust and mortgages encumbering real estate, promissory notes secured by such deeds of trust or mortgages, releases of deeds of trust and mortgages upon real estate, receipts and options for purchase contracts of sale and agreements, and by giving advice to the parties to instruments as to the legal effect thereof.

6. That, in doing the acts set out in paragraph numbered 5 hereof, the defendant, in his own person or through his agents, servants and employees, customarily in each instance: conferred with one or more of the parties to the transaction or their agents; elicited in such conference what were considered to be the pertinent facts; in the light of the information so elicited and the information contained in the abstract of title, selected and determined upon the blank form or forms to be used; and then prepared one or more of the instruments mentioned in said paragraph numbered 5 by filling in such form or forms in such manner as the defendant himself or the agent, servant or employee of the defendant preparing same, in his or her judgment, deemed proper in the light of the information elicited in such conference and the information contained in the abstract of title; and gave advice to the parties to such instruments as to legal effect of the instrument so prepared.

7. That the defendant was not a party to any of the deeds of conveyance, deeds of trust, mortgages, promissory notes, releases, receipts and options for purchase, contracts of sale, agreements and other instruments prepared by him or his agents, servants and employees as alleged in paragraph numbered 5 hereof, except that the deposit upon the purchase price,. the receipt of which was acknowledged by each receipt and option for purchase, was paid to and

held by the defendant as agent or broker; that the only connection of the defendant with the transactions, as a part of which said instruments were prepared and executed, was in the fact that the purchasers of the properties involved in such transactions had been procured by the defendant or that the lender and the borrower had been brought together by the defendant and the defendant received commissions for his services as a real estate broker in procuring such purchasers or in bringing together the lenders and the borrowers and in the fact that the receipts and options recited that the deposit on the purchase price was paid to and was to be held by the defendant as agent or broker and in the performance by the defendant (either in his own person or by his agents, servants and employees) of the services in the preparation of said instruments and in the consummation or closing of the sale of or the loan upon the real estate involved in the transactions; that, in some loan transactions, although the defendant was named in the promissory note and in the deed of trust or mortgage as being the payee of such promissory note and therefore appeared on the face of the said instruments to be a party to such instruments, either the money loaned was the money of a principal for whom the defendant was then acting and, shortly after the making of the loan, the defendant endorsed and transferred the promissory note to his said principal or it had, prior to the preparation and execution of said instruments, been agreed between the defendant and a lending corporation that the defendant should make the loan in his own name and should then endorse and transfer the promissory note to the lending corporation and that the lending corporation should then repay to the defendant the amount so loaned and such agreement was carried out.

8. That, in almost all of the transactions in which the defendant and his agents, servants and employees prepared legal instruments in the manner and circumstances hereinbefore mentioned, the defendant had been employed as a real estate broker to procure purchasers for the properties involved in the transactions and had procured purchasers for such properties and had become entitled to and was paid commissions for his services as a real estate broker in procuring such purchasers, or the defendant had been employed as a real estate broker to bring together the lender and the borrower and had brought them together and had become entitled to and was paid commissions as a real estate broker for doing so.

9. That, in the transactions in which the defendant and his agents, servants and employees prepared legal instruments in the manner and circumstances hereinbefore mentioned, the defendant made no charge for services in preparing said instruments, other than his commission for procuring the purchaser or for bringing together the lender and the borrower.

10. That the defendant is now continuing the unlawful practice of law in the manner and circumstances hereinbefore set out and that, unless restrained by order of court, the defendant will continue such unlawful practice of law.

11. That, under the statutes of the State of Colorado and the rules of the Supreme Court of the State of Colorado, no person is permitted to practice law in the State of Colorado without having previously obtained a license for that purpose from the said Supreme Court of the State of Colorado and that, under such statutes, each person to whom such a license to practice law is issued must, before being permitted to practice law in said State, take and subscribe on oath or affirmation that he will support the Constitution of the United States and of the State of Colorado and that he will in all things faithfully execute the duties of an attorney and counselor at law according to the best of his understanding and abilities. That, under the rules of the Supreme Court of the State of Colorado, in order to receive such a license to practice law in the State of Colorado, a person must submit proof of his moral and ethical qualifications and his moral and ethical qualifications must be examined into and must be found satisfactory by the said Supreme Court, and, in addition thereto, either he must have been admitted outside of the State of Colorado to the practice of law by the highest court of the jurisdiction having such power and

have practiced law in such jurisdiction for a specified number of years or he must have successfully completed two years of work in an approved college or university preliminary to the study of law and completed the three year course of an approved law school and passed a rigid examination as to his legal educational qualifications. That the practice of law in the State of Colorado is, and of right should be, confined to those persons who are so found by the Supreme Court of the State of Colorado to possess the necessary qualifications for the practice of law in said State and who satisfactorily meet the tests and furnish proof of the qualifications required by the said statutes and said rules of said Supreme Court.

12. That each of the plaintiffs Wm. Rann Newcomb and Lawrence A. Long now is and for a number of years last past has been an attorney duly licensed by the Supreme Court of the State of Colorado to practice law in the State of Colorado and actually practicing law in said State with his office in the City and County of Denver, Colorado. That the licenses which they and other attorneys have received to practice law in the State of Colorao are privileges and franchises creating property rights in them and that the same have been and are now being encroached upon and damaged by the unlawful practice of law by the defendant in the manner and circumstances hereinbefore set out and that, if such unlawful practice of law by the defendant is not restrained by order of court, the said plaintiffs Wm. Rann Newcomb and Lawrence A. Long as well as all other attorneys duly licensed to practice law in the State of Colorado and the public generally, will be greatly and irreparably damaged thereby.

13. That the interests of the public and particularly of those persons owning, buying and selling real estate and those persons making and securing loans on real estate require that the persons who, pursuant to employment prepare, in the State of Colorado, for others than themselves legal instruments by which real estate and interests therein are conveyed, acquired, encumbered released and otherwise affected shall be limited to those persons who have been found by the Supreme Court of the State of Colorado to be qualified by their education and moral and ethical qualifications to practice law in said State.

14. That plaintiffs have no adequate remedy at law.

SECOND AND FURTHER CAUSE OF ACTION

AND, FOR A SECOND AND FURTHER CAUSE OF ACTION, The plaintiffs:

1. Adopt by reference each and every allegation contained in paragraphs numbered 1, 2, 3 and 4 of the First Cause of Action hereinbefore set out.

2. Allege that for many years last past the defendant has been engaged in the unlawful practice of law in the State of Colorado by preparing for persons other than himself, as a practice and in numerous transactions, either in his own persons or through his agents, servants and employees, leases of real estate, notices terminating tenancy of real estate and demands to pay rent or vacate real estate and other instruments creating, continuing, modifying or terminating the relation of landlord and tenant with respect to real estate and by giving advice to the parties to such instruments as to the legal effect thereof.

3. Allege that the defendant was not a party to any of the leases of real estate, notices terminating tenancy of real estate and demands to pay rent or vacate real estate and other instruments creating, continuing, modifying or terminating the relation of landlord and tenant with respect to real estate prepared by him or his agents, servants and employees as alleged in paragraph numbered 2 of this cause of action, except that, in some instances, the defendant was, for convenience, named in said instruments as the lessor, although he did not then own any interest in the real estate which was the subject of said instruments and, in so doing, he was acting only as the agent of the lessor. And allege that the only connection of the defendant with the transactions, as a part of which said instruments were prepared and executed, was in the facts that the tenant had been procured by the defendant or that the landlord and the tenant had been brought together by the defendant or that the defendant had been employed by the owner of the real estate involved to manage the said real estate and that the defendant received commissions or

other form of compensation for his services as a real estate broker in procuring the tenant or in bringing together the landlord and the tenant or in managing the said real estate or that, as hereinbefore alleged, the defendant was for convenience, named in said instruments as the lessor, although he did not then own any interest in the real estate involved and, in so doing, he was acting only as agent for the lessor.

4. Allege that, in the transactions in which the defendant and his agents servants and employee prepared legal instruments in the manner and circumstances mentioned in this cause of action, the defendant made no charge for services in preparing said instruments, other than his commission or other form of compensation for procuring the tenant or for bringing together the landlord and the tenant or for managing the real estate.

5. Adopt by reference each and every allegation contained in paragraphs numbered 10, 11, 12, 13 and 14 of the First Cause of Action hereinbefore set out.

WHEREFORE, Plaintiffs pray that this Court adjudge and decree that the defendant has been and is unlawfully practicing law in the manner and circumstances hereinbefore set out and that this Court grant an injunction restraining and enjoining the defendant and his agents, servants and employees from preparing, on behalf of other persons, deeds conveying real estate, deeds of trust and mortgages encumbering real estate, promissory notes secured by such deeds of trust or mortgages, releases of deeds of trust and mortgages upon real estate, receipts and options for purchase, contracts of sale of real estate and agreements relating to and affecting real estate and the title to real estate, leases of real estate, notices terminating tenancy of real estate and demands to pay rent or vacate real estate and other instruments creating, continuing, modifying or terminating the relation of landlord and tenant with respect to real estate, or any of said instruments, whether or not the defendant charges or receives compensation for the same and whether or not the defendant has been employed as a real estate broker by one of the parties to the transaction or has procured the purchaser or the seller of the real estate involved or has brought together the lender and the borrower or the landlord and the tenant or has been employed by the owner of the real estate involved to manage the said real estate and whether or not the preparation of such legal instruments is done by or under the supervision of an attoreny employed by the defendant, and that plaintiffs have such other relief as to the Court shall deem proper, besides the costs of this action.

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The address of the Plaintiff The Denver Bar Association,, a corporation, is 319 Chamber of Commerce Bldg., Denver 2, Colorado.

The address of the Plaintiff The Colorado Bar Association, a corporation, is 319 Chamber of Commerce Bldg., Denver 2, Colorado.

DAY GIVES EVENING LECTURES AT REGIS

Judge Edward C. Day, of the Denver District Court will lecture from June 12 to August 3 on Employer-Employee Relationships and on Court Procedure in the summer evening classes conducted by Regis College on the campus. Judge Day's course, among the 30 being offered at Regis this summer, will be held from 6:30-8:20 on Tuesday and Thursday evenings.

THE OPEN END MORTAGE*

C. BLAKE HIESTER
of the Denver Bar

Nearly every American, at some time in his life, comes in contact with a mortgage instrument, and nearly every attorney is faced with the problem, at some time, of deciding on the priority of a mortgage instrument over some other mortgage instrument or some different type of lien. I am endeavoring in this article to deal with some aspects of a mortgage instrument which is designed to maintain a priority in time over other liens. The instrument concerned is know generally as an "Open End Mortgage." *The Architectural Forum* has defined an open end mortgage as a mortgage instrument which provides for additional advances at a later date, such advances to be covered by the original instrument.

In Colorado we deal generally with deeds of trust, but for the convenience of language the term mortgage in this article shall include a deed of trust, the term mortgagor shall include a grantor of a deed of trust, and the term mortgagee shall include a beneficiary under a deed of trust.

The open end mortgage is generally desirable from the standpoint of borrowers and of lenders. Frequently a mortgage secures an indebtedness which is paid back in small payments spread over a long period of time. If the mortgage is an open end one, the mortgagor can maintain and improve his mortgaged property, frequently his home, by borrowing further amounts from his original lender which further amounts will be secured by his original mortgage. If the mortgage still has a period of several years to run, the additional advance can be spread over the remaining years for repayment, and the additional monthly amount to be repaid will be relatively small. If these small payments are compared with the average personal loan so often used for the purpose of repairing or maintaining the home, or even with the FHA Title 1 loan which must be repaid within a period of three years, the advantage of the borrowing under the original open end mortgage can be readily seen.

It is true that such maintenance or repairs can be made and secured by a second mortgage, but the loan costs and higher interest rate make this type of financing much less desirable from the borrower's standpoint. The advantage of an open end mortgage to a lender can be appreciated if we will consider that his mortgage becomes increasingly valuable with the increase in the value of the security. A house which is kept in good order is better security than one which is allowed to deteriorate rapidly because its owner cannot afford necessary or desirable maintenance and repairs.

* This is an amplified version of a talk given by Mr. Heister before The Law Club of Denver on March 26, 1951.

Having briefly pointed out the advantages of the open end mortgage, I shall devote the rest of this article to a discussion of the protection such a mortgage gives to a lender. We have already seen that an open end mortgage provides for additional advances at a later date, and it is the protection given these additional advances which concerns us. It becomes immediately necessary, therefore, to distinguish between the different types of advances.

Generally speaking we can, for our purposes here, divide such additional advances into two types: those which are optional and those which are obligatory. The attempts of the courts to define these two concepts have caused much confusion on this subject. The courts have defined an optional advance in the following ways: It is optional if: (1) the mortgagee is not obligated to make it, or (2) he cannot make it without the request of the mortgagor, or (3) he may at his pleasure decline to make it, and may do so without taking the risk of subjecting himself to damages or loss. The third of these definitions seems the best, for reasons which will be seen later, and is gaining favor with the courts. The courts have generally defined an obligatory advance in one of two ways: (1) the future advance is obligatory if the mortgagee has agreed absolutely to make the advance, or (2) the mortgagee must make the future advance in order to eliminate loss. The second of these definitions seems the more reasonable and is gaining favor with the courts.

THE PRIORITY OF FUTURE ADVANCES

From the standpoint of the number of jurisdictions deciding the question there appears to be a majority and a minority doctrine concerning the priority of future advances made under an open end mortgage over intervening encumbrances. Since the recording statutes of this state and of many states would resolve the question of priority between liens one of which is not recorded, we shall assume hereafter that all liens claiming priority have been recorded, and an intervening encumbrance means one that was recorded prior to the making of an additional advance.

The rule laid down in most jurisdictions is that an advance, though purely optional, made pursuant to a mortgage of which subsequent parties had record or other sufficient notice is a lien or charge superior to an encumbrance intervening between the giving of the mortgage and the making of the advance, if the mortgagee had no knowledge and no actual notice of the intervening encumbrance. It is to be observed that such rule, where actually applied, has usually been invoked to deny effect to mere record notice of the intervening encumbrance without the sufficiency of any other form of constructive notice having been at issue.[1]

[1] In support of this doctrine see the cases cited in 138 A.L.R. 579 et seq.

The Colorado Supreme Court followed the reasoning of this majority doctrine in deciding the case of *Du Bois v. First National Bank.*[2] That case was briefly the following: One Du Bois was indebted to the First National Bank of Denver in the sum of about $7,000. As collateral security therefore and for all advances thereafter to be made to him by the bank he executed his promissory note in the sum of $25,000 secured by a trust deed on real estate. From time to time therafter Du Bois obtained further loans from the bank and gave renewal notes for them on the earlier indebtedness. Subsequent to the making of the note, Du Bois and his wife were divorced, and in the divorce decree the wife was awarded one-third interest in the real estate. After this award to the wife, the bank paid advances to Du Bois under the original mortgage. Du Bois defaulted in payment and the bank secured a decree of foreclosure on its deed of trust. The wife seeks to have this foreclosure set aside as to her one-third interest in the property. The court held for the bank and against the wife. In answer to the wife's contention that the trust deed is not a security upon her portion of the property for advances made by the bank to her husband after the maturity of the collateral note, or after she acquired her interest therein under the divorce decree, and that the rendition of the decree and the recording of her deed, which was made in pursuance thereof, operated as constructive notice to the bank of her rights, the court said:

> No question is made concerning the validity of the mortgage to cover future advances, and it is now well settled that the mortgage need not state on its face that such was its purpose. It may be silent as to that feature or it may specify a fixed sum for which the security is given, and advances within such limit are protected; the amount as well as the purpose of the security being established by oral evidence. The position of the bank is that until she gave to it actual notice of the acquisition of her interest in the property it might continue to make advances to the mortgagor, even after maturity of the mortgage notes, since the mortgage did not restrict the time within which the advances were being made which would be protected by the mortgage as to the entire property. The Trial Court apparently adopted the view of the law entertained by plaintiffs and also found as a fact that all advances which the bank made to Du Bois were made before defendant gave notice of her rights. If such is the fact it would seem from the authorities that such advances are within the lien of the mortgage.

It cannot be said that this was the actual decision because the court goes on to state that under the facts of this case that question is not a live one because the foreclosure sale did not bring in sufficient money to cover all the bank's advances. The case is frequently cited, however, for the proposition quoted.

In a more recent Colorado case, *Ferguson v. Mueller,*[3] under facts similar to the above case in that the subsequent owners of

[2] 43 Colo. 400, 96 P. 169 (1908).
[3] 115 Colo. 139, 169 P. 2d 610 (1946).

property subject to a deed of trust were concerned, the court discusses the law of open end mortgages as follows: When a mortgage in turn secures future advances, the sum named as the consideration is of no importance, because as between the parties it will be security for the money actually advanced upon it and for nothing more. The court said that no question is made concerning the validity of the mortgage to cover future advances, and it is now well-settled that the mortgage need not state on its face that such was its purpose. It may be silent as to that feature or it may specify a fixed sum for which a security is given, and advances within such limit are protected, the amount as well as the purpose of the security being established by oral evidence. The court cites *Du Bois v. First National Bank, supra.*

ACTUAL NOTICE REQUIRED, NOT JUST RECORDING

So we see that, according to the majority doctrine, actual notice of the intervening encumbrance must be had by the mortgagee making future advances in order to subject his future advances to the priority of the intervening encumbrance. There is much confusion as to what constitutes notice for this purpose, but the cases do generally hold that the mere recording of the intervening encumbrance does not constitute notice sufficient to subject the future advance made under an open end mortgage to the intervening encumbrance. The above cited and other Colorado cases have held that the mere recording of the intervening encumbrance is not notice to establish priority of an intervening encumbrance.[4] Some cases have held that actual notice necessary to establish priority of an intervening encumbrance over an optional advance must be the personal contacting by the intervening encumbrancer of the mortgagee seeking to make future advances.

According to the generally prevailing doctrine, advances made under a recorded mortgage given to secure optional advances will not be denied priority in lien merely because the intervening encumbrancer could not have determined from the mortgage without extraneous inquiry the true amount of the indebtedness or advances secured thereby.[5]

The majority doctrine discussed above is further clarified and enlarged upon in *Jones on Mortgages* as follows:

> Generally the amount intended to be advanced need not be stated, provided it can be otherwise ascertained by the description. But even where limitation is necessary in order to constitute a continuing security, which will not be affected by subsequent conveyances, a recorded mortgage for an unlimited sum is notice to a subsequent encumbrancer as to all sums advanced upon the mortgage before the subsequent lien attaches. Moreover, the record of the subsequent mortgage is no notice to such prior mortgagee, that any subsequent

[4] *See also* 138 A.L.R. 585.
[5] *Op. cit.* at 582.

> lien has attached. A subsequent mortgagee can limit the credit that may be safely given under the mortgage for future advances only by giving the holder of it express notice of his lien, and a notice also that he must make no future advances on the credit of that mortgage. The mortgage will then stand as security for the real equitable claims of the mortgagee, whether they existed at the date of the mortgage or arose afterward, but prior to the receipt of such notice. If such mortgagee is not under any obligation to make advances, and after notice of a subsequent mortgage does make further advances, to the extent of such advances the subsequent mortgagee has the right of precedence. But if such mortgagee is under obligation to make the advances, he is entitled to the security, whatever may be the encumbrances subsequently made upon the property, and whether he has notice of them or not.

Citing the proposition generally, again, *Jones on Mortgages* says the following:[6]

> In this country, mortgages made in good faith for the purpose of securing future debts have generally been sustained, both in the early and in the recent cases. Such a mortgage is valid even as against creditors and subsequent purchasers. It does not matter that the future advances are to be made to a third person, or for his benefit at the request of a mortgagor. Neither is the validity of a mortgage to secure future advances affected by the fact that the advances are to be made in materials for building instead of money. A mortgage is not fraudulent because it is given for a larger amount than the actual loan made at the time, with a view to its covering future loans up to the amount of the mortgage. Nor is the creation of subsequent valid indebtedness a fraudulent act, regardess of motive, if the mortgage secures future advances.

In contrast with this majority doctrine, the doctrine of a few cases (most of them not recently decided) provides that the lien of a so-called optional advance made without actual notice of an encumbrance intervening between the giving of the mortgage and the making of the advance, is subordinate to such encumbrance, except, of course, as a failure to record the intervening encumbrance may have produced a contrary result. The substance of this doctrine is that, for priority purposes, the optional advance is to be treated as a new mortgage taken as of the time of the advance.

Priority of Obligatory Advance

We have discussed thus far the priority of additional optional advances. Today's expanded building programs and large scale building projects make for many of us the problem of the obligatory advance even more acute, particularly where it applies to construction money paid out under the security of an original mortgage where the lender advances sums of money as the building progresses. If under the terms of the original mortgage, the lender has to advance sums to pay for work and materials during the progress of the building, he is operating under an open end mortgage which provides for obligatory future advances. *Jones*

[6] Section 448.

on Mortgages, Sec. 454 states the general law with regard to a mortgage for obligatory advances as follows:

> A mortgage for obligatory advances is a lien from its execution. If, by the terms of the mortgage, an obligation is imposed upon the mortgagee to make the advances, the mortgage will remain security for all the advances he is required to make, although other encumbrances may be put upon the property before they are made, and he has knowledge of such encumbrances.

The effect and extent of the above doctrine is brought out in *Tillinghast v. North End Savings Bank.*[7] That case was, briefly, the following: Upon a first mortgage to secure a building loan of $20,000, a bank advanced $15,000 and retained $5,000, under an agreement with the mortgagor that the latter sum should not be paid "until the said building shall be in such progress to completion that the mortgagee shall deem it safe to advance said balance." A second mortgagee acquired the equity in the property by foreclosure, and brought a bill to redeem it from the first mortgage. The bank had paid out the whole of the $5,000 retained by it upon orders from the mortgagor, leaving the amount of $450 due to it for interest. It was contended by the second mortgagee that the bank ought to have applied the amount of $450 to the payment of this interest from the $5,000 retained by it, and could not require that sum to be paid by the second mortgagee in redeeming from the bank's mortgage. It was held that the bank could not be compelled to make such set-off.

Obligatory Advances v. Mechanics' Liens

The application of the doctrine stated above concerning the priority of future obligatory advances becomes important especially, in many cases, when confronted with the priority of the mechanics' lien laws. A mortgage for future advances has, in cases where the making of such advances was apparently obligatory, been held to be a prior mortgage and the mortgagee to be a prior bona fide mortgagee, and its lien has been held not to be one attaching or originating subsequently to the commencement of the work, within the meaning of the provisions of mechanics' lien laws fixing the relative priority of such liens and other encumbrances on the property. The right of a mortgagee for future advances to priority over mechanics' liens for advances made during the progress of the work is sometimes a matter of balancing conflicting equities. When the mortgage money is to be advanced and used for the carrying on of the work, and the lien claimants have furnished labor or materials with actual or constructive notice thereof, the mortgagee is ordinarily deemed entitled to priority.

A Colorado case is enlightening on this matter. The case of *Joralmon v. McPhee*[8] was, briefly, the following: A Mrs. Snell

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[7] 178 Mass. 458, 459, 59 N.E. 1016 (1901).
[8] 31 Colo. 26, 71 P. 419 (1903).

owned land subject to two mortgages, the second of which was for the benefit of Mrs. O'Donnell. Mrs. Snell wanted to have improvements erected on the land and contracted with two gentlemen named Tooker and Joralmon to perform this work. Mrs. O'Donnell agreed to allow Joralmon and Tooker to have deeds of trust prior to hers on the condition that the money loaned by Tooker and by Joralmon would be used first to pay off the first mortgage and second to pay for the improvements to be erected on the land. All parties having agreed to this, Mrs. O'Donnell released her deed of trust. Mrs. Snell then signed promissory notes to Tooker, another to Joralmon and a third to Mrs. O'Donnell. Deeds of trust were executed and recorded in that priority. The money advanced by Tooker and Joralmon was used partly to pay off the first encumbrance as agreed upon and $2,770.10 was used to pay for the construction of improvements on the property. The improvements were not completed and and contractors, laborers, and materialmen filed mechanics' liens which they were seeking to have foreclosed. The main question raised, in which we are interested, is that of the priority of the various liens. As to the funds which had been loaned prior to the commencement of the building and which was secured by deeds of trust on record prior to the commencement of the building, the court stated that any mechanics' liens were obviously second to such mortgages to that extent. The real question with which we are concerned, is this, therefore, part of the money advanced by Joralmon and Tooker was advanced subsequent to the commencement of the building and the furnishing of materials. The court held that to the extent of the money secured by these mortgages, which was actually extended for the construction of the improvements, the mortgages of Tooker and Joralmon were prior to the mechanics' liens. In holding this the court said:

> Where mechanics and material-men have notice of the existence of a mortgage, which is given expressly for the purpose of securing funds to construct an improvement and to know that the funds thus obtained are being applied in that way, their rights must be held subordinate to that of the mortgagee to the extent of such advances because of this knowledge. In other words, when they know that a structure upon which they are engaged has been pledged as security for advances to be applied toward its construction by a contract entered into before the work of erection was commenced they are bound by such an arrangement up to the extent that funds under such contract are actually advanced and applied to construct the building. So, where the advances are all made before the work is done, or material furnished the equity of the mortgagee is superior to that of the lien claimant.

After having determined generally what the law is with respect to the priority of the lien of a mortgage for future advances it becomes important to know what amounts to a mortgage for future advances. Obviously a mortgage instrument which describes, in clear language, that it secures a specifically mentioned indebtedness plus additional advances of certain amounts or up to a certain amount is such a mortgage. As to those mortgages which are not absolutely clear I can but cite examples of some which were adjudicated to be mortgages for future advances and those which were adjudicated not to be and let the reader decide for himself how best to word such a mortgage.[9]

CASES ON MORTGAGES FOR FUTURE ADVANCES

An Arkansas case decided that a mortgage which provides that it shall be security for a debt of $100.00 to mature in the future, "and all other indebtedness which may then be due" to the mortgagee by the mortgagor will cover future advances."

A California case is cited for the proposition that a mortgage to secure "all moneys due or hereafter to become due" does not relate merely to existing indebtedness, but secures future loans and advances as well.

An Iowa case is cited for the proposition that a conditional deed, containing a clause providing that the property shall be reconveyed on the payment of the grantee of a "sum of money equal to all claims and evidences of indebtedness that the grantee shall have against" the grantor may be a mortgage for future advances.

A Maine case is cited for the proposition that a mortgage purporting to secure the repayment of a certain amount and "also all other debts which the mortgagor may contract with the mortgagee" will cover future advances.

A Michigan case is cited for the proposition that the fact that a mortgage recites a stated consideration does not prevent it from being a mortgage to cover future advances, where the mortgagor covenants to repay such sum and also "any sum of money which he may now or hereafter owe said mortgagee by reason of any note, check, draft or other paper upon which his name shall appear, either as maker or otherwise; and this mortgage and its accompanying note, until discharged, is to be a continuing security for payment of any such sum or sums."

An Illinois case is cited for the proposition that a mortgage given to secure monthly installments of rents, to become due in the future, is not one to secure future optional advances, although the landlord, under the terms of the lease, was entitled to terminate it upon non-payment of any installment of rent.

Another Maîne case is cited for the fact that a bill of sale given to one "as security for his liability upon certain notes" endorsed by him, the amount of which is not given, does not cover future liability by endorsement.

[9] The specific citations for the cases mentioned can be found in 1 A.L.R. 1586.

A Minnesota case is cited for the proposition that a mortgage which recites that it is given as collateral security for the payment of certain book accounts, "according to the terms of a certain contract bearing even date herewith," which did not provide for future advances to the mortgagor, cannot be treated as one for future advances.

As a general rule, advances in excess of the amount of a mortgage are not secured by it; however, it is stated that a limitation in terms of the amount of the advances to be made may be controlled by other expressions in the mortgage as to the purpose of the advances; thus where the controlling purpose was to secure advances sufficient to enable the mortgagor to raise a crop of cotton advances beyond the sum specified were protected.

A wider understanding of the open end mortgage and the protection it gives a lender might lead to better and easier home development and maintenance, and might resolve many questions concerning the relative safety of making advances under an existing mortgage.

SUPREME COURT ADOPTS AMENDMENTS TO RULES OF CIVIL PROCEDURE

On May 17, 1951, the Supreme Court of Colorado announced the approval of the amendments to the Colorado Rules of Civil Procedure embodied in the reports of its Rules Committee submitted on September 1, 1948 and January 4, 1950.

The effective date of the amendments will be August 18, 1951 and sometime prior thereto *Dicta* and the bar associations hope to publish and have in your hands a copy of these amendments.

Some 37 of the amendments were made to bring the Colorado Rules into conformity with the 1947 changes to the Federal Rules, two amendments were made to the Appendix of Forms for the same purpose, and eleven other amendments were approved in accordance with the recommendations of the committee.

The Rules Committee of the Supreme Court is composed of Jean S. Breitenstein, chairman; Joseph G. Hodges, V. H. Johnson, Thomas Keely, and Percy S. Morris.

THE "PRUDENT MAN RULE" NOW APPLIES TO INVESTMENTS BY FIDUCIARIES

CHARLES A. BAER
of the Denver Bar

Colorado has had in its Constitution a prohibition against the investment of funds held in estates and trusts in the stocks or bonds of private corporations.[1] At the last general election, there was included in Constitutional Amendment No. 2 a provision which permitted the General Assembly to enact legislation by which fiduciaries might invest in such stocks and bonds.[2]

The legislature, in pursuance of this provision of Constitutional Amendment No. 2 enacted, and the Governor signed, H.B. 272. The Governor's signature was affixed on March 29, 1951. The statutes of the State of Colorado, therefore, now contain this particular bill as well as previous statutes relating to investments.[3]

The statute adopted by our legislature is one which might be referred to as a model "Prudent Man Rule" type of investment statute. Colorado, according to my information, is the 25th state having the prudent man rule by judicial construction or by statute, many of them similar to that referred to. In no state where such a statute has been adopted has there been a return to the old type of investment practice which we have followed in Colorado for many years, namely, the enactment of a legal list by our legislature or by the creation of a commission which adopts a legal list for the guidance of fiduciaries. Even where the legal list has been in existence, the courts have, in considering the propriety of particular investments, surcharged or refused to surcharge the fiduciary on what might be called the "Prudent Man Rule" of conduct. Some courts have held that a purchase within the legal list removed the fiduciary from liability for investing improperly. Of course these cases arise where the asset purchased by the fiduciary has depreciated in value through some set of events. However, in most such cases there are other factors involved, such as self-dealing, improper appraisals and holding improperly after receipt of information, which indicates that the investment is improper and of questionable value.

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[1] COLO. CONST. Art. V, § 36.

[2] The General Assembly shall from time to time enact laws prescribing types or classes of investments where the investment of funds held by executors, administrators, guardians, conservators and other trustees, whose power of investment is not set out in the instrument creating the trust.

[3] Statutes as of April 13, 1951 were all in COLO. STAT. ANN., c. 176: Sec. 126—repealed 1937; Sec. 126(1)—repealed as to (c) 1945 (Exec., etc.); repealed as to (b) 1951 fiduciaries, still effective as to (a); Sec. 126 (2)—repealed as to executors, administrators, guardians, trustees 1945; still effective as to all others named; Sec. 126 (3)—repealed as to (c) 1945; repealed as to (b) 1951; still effective as to (a); Sec. 126 (4)—repealed except as to its use in conjunction with Sec. 13 Chapter 235 Session Laws of Colo. (Uniform Veteran Guardianship Act) applying to minors and incompetents receiving benefits from V.A.

The question then is, "What is the Prudent Man Rule?" From talking with many attorneys here in Denver, and in Colorado, I realize that there are many different notions of what those words mean. There are even some who feel that the adoption of this statute amounts to a general invitation to carelessness in trust investments, especially where individuals are acting as fiduciaries. However, it is my belief that this is not so; rather, that the adoption of this statute imposes upon fiduciaries a higher degree of care and skill in investing than that which we have had previously. As long ago as 1830, Mr. Justice Putnam in the case of *Harvard College v. Amory,* the basic decision from which the American rule evolves, said:

> He [the fiduciary] is to observe how men of prudence, discretion, and intelligence manage their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of the capital to be invested.[4]

Very much the same wording is to be found in other early cases,[5] and there is quite a lengthy statement on the rule in *Scott on Trusts,* Section 227. The Restatement of the Law on Trusts reads as follows:

> (Section 227). In making investments of trust funds the trustee is under a duty to the beneficiary;
>
> (a) In the absence of provisions in the terms of the trust or statute otherwise providing, to make such investments and only such investments as a prudent man would make of his own property. having primarily in view the preservation of the estate and the amount and regularity of the income to be derived.

It is my belief that the fiduciary is not ordinarily bound to the highest degree of care, but only to the degree of care used by the reasonably prudent man. This is so in investments even though in other matters a fiduciary is held to strict accountability. It is quite different from and lower than the level or quality of honesty required of a fiduciary.

The purpose of this article is only to acquaint you with the passage of this statute and not to answer all the questions which might immediately occur to you. From conversations I have had with the deans of our law schools, I am sure that we will have articles in *Dicta* and *The Rocky Mountain Law Review* covering comprehensively the problems presented. It might be well, however, to mention some of the problems which face us:

1. The Prudent Man Rule is without doubt the rule of investment to follow in all guardianships and conservatorships other than those in which funds are received from the Veterans Administration.

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[4] Harvard College v. Amory, 9 Pick 446, 461, (Mass. 1830).

[5] King v. Talbot, 40 N. Y. 76 (1869); Mattocks v. Moulton, 84 Me. 545, 24 A. 1004 (1892).

2. The Prudent Man Rule undoubtedly should be used in investing in all cases where the will is silent on the problem.

3. The Prudent Man Rule should be followed in conjunction with Section 147, Chapter 176, in holding investments in any estate where the will is silent or in any estate where there is no will.

4. In all trusts created under contract, and in all testamentary trusts, reappraisal of the investment problem and of the investment clause must be made. The rule does not limit the express provisions of such trusts, but rather should be read in connection therewith, just as it should have been before the passage of the statute in connection with those accounts wherein the trustee was given unlimited discretion in the investing of the funds. Typical as examples of such problems are clauses as follows:

(a) To "invest and reinvest" where undoubtedly the rule now applies.

(b) To "invest and reinvest in safe, interest bearing securities" where undoubtedly the rule applies within the limits of what are interest bearing securities such as bonds and notes.

(c) To "invest and reinvest in those securities prescribed as legal by the State of Colorado" wherein the rule undoubtedly applies to investments made after March 29.

(d) To "invest and reinvest in Government bonds, municipal bonds, and loans secured by a first mortgage on Colorado real estate not in excess of 50% of the value of such real estate" wherein the rule probably does not apply except insofar as it is superimposed in purchasing the municipal bonds and the mortgages.
The cases on these points are decided by the courts under the rules of construction regarding intent of the testator.

5. It also presents a problem to the draftsmen of new wills and trust agreements. In my opinion such draftsmen should, as in the past, incorporate in the trust instrument a complete investment clause setting forth the ideas and desires of the testator or trustor and limiting or giving discretion to the trustee as desired. The well-drawn trust instrument does not rely on the changing conditions of our economy or of the ideas of our legislature.

6. The attorney for a fiduciary must now advise his client that in investing funds such client must investigate with the care and skill of ordinary prudent men from the sources which such men use whether the asset to be purchased is proper for the particular fund. One therefore doesn't buy particular investments from a salesman on the word of the salesman alone unless such individual has a knowledge of the facts and conditions separate and apart from that of the salesman.

LIEBHARDT V. AVISON: REMAINDERS AND REVISION

Three types of remainders will be involved in this comment on *Liebhardt v. Avison*:[1]

1. "To A for life, remainder to B and his heirs."
2. "To A for life, remainder to B and his heirs, if B survives A."
3. "To A for life, remainder to B and his heirs, but if B dies before A, then to C and his heirs."

The opinion bases the decision upon the distinction between type 1 and type 2. It would have been more orthodox had the same decision been based upon the distinction between type 1 and type 3. Type 1 is a vested remainder in fee simple *absolute.* Type 2 is a contingent remainder, that is, B's survivorship is a condition precedent to the vesting of the estate in him. Type 3 is a vested remainder subject to divestment by an executory limitation, that is, B's failure to survive A is an event which will divest the fee simple which has been vested in him.

The significance of the distinction between type 2 and type 3 has been stated by the American Law Institute as follows:[2]

> . . . In some controversies the rule stated [§250 (d)] becomes important because of the difference in the rules applicable respectively to future interests subject to a condition precedent [type 2] and to future interests vested subject to complete defeasance [type 3]. This situation exists often in problems of taxation; in questions involving the destructive operation of the rule against perpetuities; in determining the possibility of merger between a present interest and a remainder; in determining whether the interest in question is accelerated upon the failure of a prior interest, in ascertaining the person entitled to receive otherwise undisposed of income and in deciding the type of protection to be accorded to the future interest . . . also . . . in determining the type of reversionary interest left in the conveyor . . .

When such cases have to be decided in Colorado, the opinion in *Liebhardt* v. *Avison* may lead to unorthodox results because it classifies as contingent remainders [type 2], remainders which, it is believed, should have been classified as vested subject to divestment [type 3].

The court was using ". . . the rule of construction which we applied in *Williams v. Fundingsland,* 74 Colo. 315, 321, 221 Pac. 1084, that, 'The use of different words in a will applying to the same subject matter, indicates that the testator had in view different results'."

[1] —Colo.—, 229 P. 2d 933 (1951). The case is not stated because it is assumed that the reader of this comment has read the opinion.

[2] RESTATEMENT OF THE LAW OF PROPERTY (1940) § 250, Comment j.

This rule was used by the court as a reason for concluding that since in paragraphs 15 (a), 15 (b), and 16 (b) the testator used words which created (type 2) contingent remainders, he intended something different, that is, a (type 1) vested remainder in fee simple absolute, by the different words of paragraph 16 (c).

The same rule could have been used to the same effect, but with less risk of leading to error in subsequent cases, if the court had concluded that since in paragraphs 15 (a), 15 (b), and 16 (b) the testator used words which created (type 3) vested remainders subject to divestment by executory limitations, he intended something different, that is, a (type 1) vested remainder in fee simple absolute, by the different words of paragraph 16 (c).

Paragraphs 15 (a) and (b) will be studied first. There are five reasons why the remainder which it creates should be classified as (type 3) vested subject to divestment by an executory limitation.

First: The remainder is "to the issue of Georgia . . . living at the time of my [the testator's] death . . .". The identity of each remainderman was therefore as definitely determined at the death of the testator as it would have been had he said, "to John, James, and Mary, the children of my niece Georgia." This "present identification" of existing persons as the intended takers of the remainder tends to establish that survival until the time of distribution is not a condition precedent.[3]

Moreover, the express requirement that the remaindermen be living at a certain time indicates that no such requirement is to be implied as of a later time. This follows from the rule of construction which the court was applying. With reference to the time of his death, the testator used words requiring survivorship; with reference to the time of distribution, he did not. "The use of different words in a will applying to the same subject matter, indicates that the testator had in view different results."

Second: The condition precedent which might be inferred from the words, "Upon the death of both Harry . . . and Georgia" is nullified by the the fact that life estates in the same property had been given to Harry and to Georgia.[4]

Third: The condition precedent which might be inferred from the words, "when they reach the age of twenty-six years" is

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[3] RESTATEMENT, *supra*, § 256, Comment c.

[4] SIMES, THE LAW OF FUTURE INTERESTS (1936) § 74, note 26, citing twenty-six cases, (a list "by no means exhaustive") including Dowd v. Scally (Iowa) 174 N.W. 938, 940 (1919), "If there be any one proposition in the law of remainders which may be regarded as settled, it is the one here stated. '. . . Where the devise is to the remainderman "from and after" or "after" or "at" or "*on*" the death of the life tenant, or words of like import are used, the authorities quite generally declare that such words relate to the time of enjoyment, and that the remainder is vested.' "

nullified by the gift of income from the same property to the same persons until they reach the age of twenty-six years.[5]

Fourth: The words "I *give* to the issue of Georgia . . . living at the time of my death . . . for their *absolute* property when they reach the age of 26" afford the basis for inference that the gift was vested under the rule in *Clobberie's* Case, ". . . if money be *given* to one, *to be paid* at the age of twenty-one years; there, if the party dies before, it shall go to [his] executor."[7] Thus the vesting is immediate, only the enjoyment is postponed.

The same effect should be given to a subsequent phrase, "before receiving the fee title to said real estate and before receiving the principal of said property protective fund and the accumulations thereof." This is paraphrased in the opinion as, "before receiving the trust property." It is believed that this is a correct paraphrase. "Recieving the title to said real estate" seems to refer not to the vesting of the interest, but rather to receiving the legal title from the trustees; and so also as to receiving the personal property which had been held in trust.

Furthermore, the term "absolute property" seems more properly to point to a distinction between property that is absolute (type 1) and property that is subject to defeasance (type 3), rather than to a distinction between absolute property (type 1) and no property at all (type 2).

Fifth: The gift over "in case of Georgia['s] issue living at my death dying *without issue* before reaching the age of twenty-six years" strongly indicates a vested interest subject to divestment (type 3).

The testator has said that there shall be a gift over if the remaindermen die *without* issue before reaching twenty-six. But what if they die *with* issue before twenty-six? In such an event there is no gift over. The inference is that the interest has already been vested and that it will be a part of of the estate of the remainderman.[8]

It is hoped that this discussion will have pointed out the significance of the italicized words in paragraphs 15 (a) and 15 (b).

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[5] RESTATEMENT, *supra*, § 258, Comment m, "The rule stated in this section is one of the most potent factors in construction. . . . when this rule is applicable a condition precedent of survival is thereby eliminated unless extremely strong counterbalancing factors are present . . . the rule is sufficient to change the effect of limitation, which apart from the gift of income would clearly include a condition precedent of survival."

SIMES, *supra*, § 356, note 44, citing seventeen cases, including Fidelity Union Trust Co. v. Rowland, 132 A. 673 (N.J., 1926). ". . . $50,000 in trust . . . to . . . apply net income to maintenance, support and education of Charles . . . until he attain the age of thirty years, and upon [Charles] attaining the age of thirty years, I give [Charles] . . . principal sum of $50,000."

"The authorities are agreed in holding that legacies in terms of the one under consideration are vested. . . . The trustee is advised that the legacy vested in Charles . . . and upon his death passed to his administrators . . . although [Charles] would not now be thirty had he lived."

[6] 2 Vent. 342 (1677).

[7] See also in accord, with respect to land as well as to personalty: RESTATEMENT, *supra*, § 257, particularly illustration 1, and SIMES, *supra*, § 355, note 37, citing fifteen cases.

[8] RESTATEMENT, *supra*, § 254, particularly, illustration 3 and comment b, "The force of the tendency stated in [§ 254a, that 'the restricted requirement of survival . . . is a basis for the defeasance of such interest rather than a condition precedent thereof] is very strong, being counteracted only in rare situations."

SIMES, *supra*. § 358.

> (a) The net income of said real estate I give, devise and bequeath to Harry G. Liebhardt and Georgia Liebhardt Temple, share and share alike, *for their natural lives.*
>
> Upon and after ten (10) years from the date of my death, the net income from the said property protective fund and the accumulations thereof I give, devise and bequeath to Harry G. Liebhardt and Georgia Liebhardt Temple, for their natural lives, share and share alike.
>
> In the event that Harry G. Liebhardt dies before Georgia Liebhardt Temple, then and in that event the entire net income of the said property protective fund and the accumulations thereof, after ten (10) years from the date of my death, and the entire net income of said real estate, I give, devise and bequeath to Georgia Liebhardt Temple, for her natural life.
>
> Upon the death of Georgia Liebhardt Temple, either before or after the death of Harry G. Liebhardt, her share of said *net income* of said real estate and of the said property protective fund and the accumulations thereof, *I give, devise and bequeath to her issue living at the time of my death,* share and share alike.
>
> All of said income herein bequeathed and devised shall be paid to the beneficiaries quarter-annually.
>
> *Upon the death* of both Harry G. Liebhardt and Georgia Liebhardt Temple, all of said above described real estate and the income therefrom, and the said property protective fund and the accumulations thereof, *I give, devise and bequeath to the issue of Georgia Liebhardt Temple living at the time of my death,* share and share alike, *for their absolute property, when they reach the age of twenty-six* (26) *years.*
>
> (b) Upon the death of said Harry G. Liebhardt and Georgia Liebhardt Temple, and in case of Georgia Liebhardt Temple's issue living at the time of my death dying *without issue* before reaching the age of twenty-six (26) years and *before receiving the fee title* to said real estate and *before receiving the principal* of said property protective fund and the accumulations thereof, then the share of the income theretofore received by said issue of Georgia Liebhardt Temple I give, devise and bequeath, as follows: one-half thereof to the German Protestant Churches of Denver, Colorado and the English Lutheran Churches of Denver, Colorado, share and share alike, and the other one-half thereof to the Evangelical Lutheran Sanitarium located in Jefferson County, Colorado. If said German Protestant Churches of Denver have ceased to exist, then the said share of said income bequeathed to them I give, devise and bequeath to said English Lutheran Churches of Denver, share and share alike.

With respect to this part of the will the court said, "It thus becomes evident . . . that he [testator] could, and did, by apt language, defer the vesting of a remainder to a time subsequent to his own death, making such vesting dependent upon the survival of the remaindermen until such time, and direct the disposition of the remainder in the event of the death of the remaindermen prior to the time fixed for such vesting. We can only conclude that the testator himself had fully in mind the difference between a contingent [type 2] and a vested [type 1] remainder."

It would have involved less risk of error in future cases if the court had said, " It thus becomes evident . . . that he [testator] could, and did, by apt language provide for the *divesting* of a remainder at a time subsequent to his own death, making such *divestment* dependent upon the failure of the remaindermen to survive until such time, and direct the disposition of the interest in the event of the remaindermen without issue prior to the time fixed. We can only conclude that the testator himself had fully in mind the difference between an *absolutely* vested remainder [type 1] and a remainder *subject to divestment* [type 3].

So far this comment has been confined to the court's reference to paragraphs 15 (a) and 15 (b). The same sort of comment should be made concerning the court's reference to paragraph 16 (b).

The court treats paragraph 16 (b) as a type 2 contingent remainder, whereas it would have been orthodox to treat it as a type 3 vested remainder subject to divestment by an executory limitation. There are four reasons for this conclusion.

First: The remainderman is identified (by name) at the death of the testator.[9]

Second: The condition precedent which might be inferred from the phrase, "Upon the death of Georgia," is explained by referring it to that part of the property in which Georgia had been given an estate for life.[10]

Third: The condition precedent which might be inferred from the words, "when . . . Jack . . . shall have reached the age of thirty years," is nullified by the gift of income, part to be paid to him, and the excess to be accumulated for him until he reached the age of thirty. [11] The rule is the same even though only a part of the income is to be given for maintenance.[12]

Fourth: The gift over "upon the death of Jack . . . *without issue*, before being entitled to receive and before receiving said property" justifies the inference that an interest has been vested in Jack upon the death of the testator, and that it is to be divested only by his death before thirty, *without issue*.[13]

The language of paragraph 16 (b) is as follows: (The words which have been discussed are italicized.)

> Upon the death of both Minnie K. Liebhardt and Laura L. Liebhardt, I give, devise and bequeath *the net income* of the undivided one-half interest in and to said Lots seventeen (17), eighteen (18) and nineteen (19), Block one hundred sixty-one (161), East Denver, to my niece, Georgia Liebhardt Temple, for and during her natural life and *to her son Jack Liebhardt Temple*, share and share alike, to be paid as hereinafter provided. The share of said net income belonging to Georgia Liebhardt Temple shall be paid to her by said successors in trust quarter-annually. The share of said net income belonging to Jack Liebhardt Temple shall be paid to him by said successors in trust at the rate of Three Hundred Dollars ($300.00) per month, until he reaches the age of twenty-six (26) years, and between the age of twenty-six (26) and thirty (30) years, the said share of said net income shall be paid to him by said successors in trust at the rate of Six Hundred Dollars ($600.00) per month.
>
> The excess of said net income belonging to Jack Liebhardt Temple over and above said Three Hundred Dollars ($300.00) per month, and over and above said Six Hundred Dollars ($600.00) per month, respectively, shall be invested and held in trust for him by said

[9] See *Supra*, first reason as to paragraphs 15 (a) and 15 (b).
[10] See *Supra*, first reason as to paragraphs 15 (a) and 15 (b).
[11] See *Supra*, third reason as to paragraphs 15 (a) and 15 (b).
[12] SIMES, *supra*, § 356, note 45.
[13] See *Supra*, fifth reason as to paragraphs 15 (a) and 15 (b).

> sucessors in trust until he reaches the age of thirty (30) years, and when he reaches the age of thirty (30) years, said excess of income, and the accumulations thereof, shall be paid to him as his own property.
>
> *Upon the death of Georgia Liebhardt Temple, and when said Jack Liebhardt Temple shall have reached the age of thirty* (30) *years, then the* entire undivided one-half interest in and to said Lots seventeen (17), eighteen (18) and nineteen (19), Block one hundred sixty-one (161), East Denver, shall be turned over and conveyed to said Jack Liebhardt Temple as and for his absolute property.
>
> Upon the death of Georgia Liebhardt Temple, and upon the death of Jack Liebhardt Temple *without issue,* before being entitled to receive and before receiving said property as above provided, then the net income of said undivided one-half interest in said Lots seventeen (17), eighteen (18) and nineteen (19), Block one hundred sixty-one (161), East Denver, shall be distributed, and I give, devise and bequeath the said net income as follows: one-eighth of said net income to the City and County of Denver, Colorado, to maintain a water and field lily garden in Washington Park; five eighths of said net income to the Protestant Orphanages of Denver, Colorado, share and share alike, and one-fourth of said net income to be paid, yearly, to the Town of McGregor, Iowa, for park purposes.

As to this the court said, ". . . testator indicated that he knew how to provide for an estate which should not vest immediately . . . Thus in section (b) there is a provision for deferment of vesting (type 2). Jack Liebhardt Temple had to live to be thirty years of age before taking. Then follows a provision for conveyance over if the conditions for the deferred vesting are not fulfilled."

It would have been less conducive to error if the court had said, ". . . testator indicated that he knew how to provide for an estate which would not vest absolutely . . . Thus in section (b) there is a provision for divestment (type 3). Jack Liebhardt Temple had to live to be thirty years of age or had to die with issue in order to prevent divestment. Then follows a provision for conveyance over if the conditions for the divestment are fulfilled."

It seems strange that this idea of vesting subject to divestment (type 3) as opposed to absolute vesting does not appear in the court's reasoning. It quotes the conclusions of law of the trial court wherein the idea is twice expressed: ". . . Fred . . . and Harry . . . each took an *indefeasibly* vested remainder . . .;" and ". . . Fred . . . and Harry . . . each took an *indefeasibly* vested interest."

Furthermore, the Brief and Argument of Defendants in Error contained this language: "We shall now demonstrate that the language of this subparagraph (c) is the language of immediate and *absolute* vesting . . . ;" and ". . . unless the expressed intention of the testator clearly appears in the will to the contrary, an *absolute,* rather than a *qualified,* a vested rather than a contingent, interest or estate is created."

There is another part of the opinion from which an erroneous inference may be drawn:

> Counsel argue that the interest which Harry . . . took should be treated as a lapsed legacy . . . This argument could only be applicable in the event that Harry ['s] . . . interest . . . was a contingent, instead of a vested remainder. It cannot apply as long as Harry

> . . . has a vested remainder, because if it is the latter it then becomes part of his estate and is disposed of by his will. . ."

This seems to be based upon the assumption that no contingent remainder can be inherited or devised. There is much authority to the contrary.[14] Of course if the contingency is the survival of the remainderman until some future time and he dies too soon, the contingency can never happen, and it is for that reason that no remainder goes to his heir or devisee.

A similar observation should be made with reference to the apparent implication that every vested remainder goes to the heir or devisee of the remainderman. Not so, obviously, if the remainder were an estate for the life of the remainderman; and for the same reason, not so if the vested remainder were divested by the death of the remainderman under circumstances which fell within the terms of the executory limitation, as, for example, the death of Jack before thirty without issue.

One more point. The court says, ". . . We believe also that the rule laid down in our statute, section 4, [article 1], chapter 40, '35 C. S. A. . . . is applicable here . . . We recently applied that rule in *Garvin v. Ruston,* 121 Colo. 494, 218 P. 2d 1064." But section 47, article 1, chapter 40, '35 C. S. A. says, "This article shall *not* be so construed as to embrace last wills and testaments." This case, *Liebhardt v. Avison,* involves a will. *Garvin v. Ruston* involved a partnership agreement, not a will.

If anyone should read this far prior to 1953, it might be well for him to ask some member of the Commission on Statute Revision to read the preceding paragraph.

T. G. M.

PERSONALS

Bernard E. Engler has removed his law offices from the Equitable Bldg. to the Majestic Bldg. Benjamin C. Hilliard, Jr., and Barkley L. Clanahan will continue as partners at 242 Equitable Bldg. under the firm name of Hilliard & Clanahan, with James J. Delaney and Robert L. Knous as associates.

John L. Griffith, formerly Clerk of the Denver County Court, is resuming the practice of law in partnership with Mary C. Griffith in the Midland Savings Building. Judge David Brofman appointed William B. Miller to be Clerk of the Court following Mr. Griffith's resignation.

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[14] SIMES, *supra,* § 732, note 12, ". . . at the present time, with the exception of Maryland, it is everywhere held that remainders, whether vested or contingent . . . descend in the same manner and to the same persons as possessory interests in land . . .'

§ 731, note 10, reads, "It is clear that, with the exception if possibilities of reverter and rights of entry for condition broken, all varieties of future interests whether vested or contingent are alienable by will in the United States."

RESTATEMENT, *supra,* § 164 and § 165.

FEENEY V. MAHONEY: RULES ON LAPSED LEGACIES

VICTOR B. GRANDY*

Among the many cases decided by the Colorado Supreme Court in 1950 the case of *Feeney v. Mahoney*[1] should prove of interest to those members of the Colorado bar who come into contact with many wills problems.

Circumstances of the case follow: Joseph P. Boyle executed the will in question on March 23, 1943. He later became insane and died on October 21, 1948. His sister, Bridget Feeney, a beneficiary under the will, preceded him in death; however, her death occurred after Boyle had become insane. Relevant provisions of the will are as follows:[2]

> Second: To my beloved sister, Mrs. Bridget Feeney, . . . I give and bequeath the sum of SIX THOUSAND DOLLARS ($6,000.00) for herself, her heirs, personal representatives and assigns forever . . .
>
> Third: To my beloved brother, Mike O'Boyle, . . . I give and bequeath the sum of FOUR THOUSAND DOLLARS ($4,000.00) for himself, his heirs, personal representatives and assigns forever.
>
> Fourth: To my beloved brother, John O'Boyle, . . . I give and bequeath the sum of FOUR THOUSAND DOLLARS ($4,000.00) for himself, his heirs, personal representatives and assigns forever.
>
> Fifth: All the rest, remainder and residue of my property, of every kind and character, real, personal and mixed, and wheresoever situate, I give, devise and bequeath unto . . . Mrs. Bridget Feeney, . . . Mike O'Boyle, and . . . John O'Boyle, share and share alike and in equal portions, for themselves, their heirs, personal representatives and assigns, forever.

The executor petitioned the county court for a construction of the will. Judgment was given in the county court declaring that the general legacy given to Bridget Feeney under the second provision of the will lapsed and went into the residue of the estate upon her death prior to that of the testator. The county court further declared that Mike and John O'Boyle should each take one-half of the residuary estate including the lapsed general legacy and the lapsed share of the residuary estate given Bridget Feeney under the fifth paragraph of the will.

On appeal, plaintiffs in error were John Feeney, minor son of Bridget Feeney, and Patrick Feeney, her husband. The Supreme Court affirmed that portion of the county court judgment holding that the general legacy to Bridget Feeney lapsed and went into the residuum but reversed the part holding that the residue be divided equally between the surviving residuary legatees. The Supreme Court took the position the lapsed residuary legacy was part of the testator's intestate estate to be distributed under the statute of descent and distribution.

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* Student, University of Denver College of Law.

[1] In Re Boyle's Estate, 121 Colo. 599, 221 P. 2d 357 (1950). The court construed the opinion in an appeal of the order and judgment of distribution based thereon and reported in 1950-51 CBA Advance Sheets 277 (No. 15 for April 21, 1951).

[2] From the opinion of Mr. Justice Holland. In the second case Justice Holland joined Justices Alter and Hilliard in dissent.

STATUTORY PROVISIONS AFFECTING LAPSED LEGACIES

In construing the will in question the Supreme Court had an opportunity to discuss amendments[3] to Section 45, Chapter 176, of 1935 Colorado Statutes Annotated.[4] Section 45, the "anti-lapse" statute, was amended to read as follows:

> Section 45. Whenever a devisee or legatee in any last will, being a *descendant* of the testator, shall die before such testator, and no provision shall be made for such contingency, the issue, if any there be, of such devisee or legatee, shall take per stirpes the estate devised or bequeathed, as the devisee or legatee would have taken had he survived the testator, and if there be no such issue at the time of the death of the testator, the estate disposed of by such devise or legacy shall be considered, treated and deemed a part of the residue of the estate of such testator. [Italics supplied].

The amendment substitutes the word "descendant" for the previous wording "child or grandchild." The court held that Bridget Feeney was not "a descendant of the testator as provided for in the statute to prevent a lapse of the legacy." By this holding the court limits, and not without precedent,[5] the meaning of the word "descendant" as used in the statute to describe persons proceeding from the body of the testator as opposed to a meaning descriptive of those upon whom property has been cast by descent which can be lineal or collateral. Because of this construction, the "anti-lapse statute" still applies only where the legacy is to issue of the testator or their *lineal* descendants only. An "anti-lapse" statute similar to the one in Colorado is found in the laws of New York.[6] However, the New York statute includes the words "or to a brother or a sister of the testator." There would have been no problem in applying the statute to the situation in the *Boyle* case had the legislature used the language added in the New York statute.

The second section of the amendment reads:

> If any devise or legacy under any will shall lapse, such devise or legacy shall be considered, treated and be deemed a part of the residue of the estate of the testator.

In the opinion of the Colorado Supreme Court ". . . the above quoted section refers to the lapsing of legacies outside the residue, and is not so all inclusive as to include the lapsing of a residuary legacy under any and all circumstances." Had the legislature intended "to include the lapsing of residuary legacies, it failed to employ available words to effectuate that intention."[7] The court feels that the use of the language "any devise or legacy" does not refer to residuary devises and legacies since it does not specifically say anything about them in so many words. This interpretation of the word "any" in a statute runs contra to many decisions in other courts including the United States Supreme

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[3] COLO. LAWS, c. 254, §§ 1, 2 (1949).

[4] These sections were to affect pending as well as future estates by provision of Section 15, Chapter 254, '49 Session Laws.

[5] In re Tinker's Estate, 91 Okla. 21, 215 P. 779 (1923).

[6] New York Decedent Estate Law, Section 29.

[7] ...... Colo. ......, 221 P. 2d 357, 362 (1950).

Court.[8] The usual definition of the word in legal terminology gives it the full meaning of "every" or "all."[9] However, the meaning of the word is not constant, and there is authority to the effect that it can mean "some," "either," and many other things according to the context of the statute.[10]

The law is well-settled that a legacy lapses by the death of the legatee prior to that of the testator unless there are words of substitution or some other provision in the will or a statute preventing such lapse.[11] The main reason given for such a rule is that a will is ambulatory and does not take effect until the death of the testator, so the legacy never vests until the testator dies. If the legatee dies before the testator, there is no one in whom the legacy can vest.

Thus it appears that the decision in *Feeney v. Mahoney* was in accord with the common law in so far as the lapsing of the legacies to Bridget Feeney was concerned. The will provided that the legacy in question in both provisions affected should go to Bridget Feeney ". . . for herself, her heirs, personal representatives and assigns . . ." This language would indicate a gift to Bridget Feeney alone since the words follow the usual pattern of those used to indicate limitation rather than substitution. This is especially true in view of the fact that nowhere in the will is a contrary intent shown.

Disposition of Lapsed Legacies

The next question to be considered is the disposition to be made of the legacies since they have lapsed. Under the prevailing common law rule a general legacy, such as the one under clause 2 of the will which lapses because of the prior death of the legatee, falls into the residue, if there is nothing in the will providing for an alternative disposition of the legacy and the residuary clause itself is not void.[12] The validity of the residuary clause here involved is not questioned since it follows the customary language and is to specific persons. The main complication arises from the fact the legatee is also a residuary legatee. There are several ways in which the "intent of the testator" might be determined. One rule is that the legacy will not fall into the residue when the legatee is also a residuary legatee, but goes immediately as intestate property. Another rule is that the lapsed legacy falls into the residue and is to be divided between the surviving residuary legatees. Still another rule is that the legacy, having lapsed, falls into the residue, but the share of the legacy which would have gone to the deceased legatee goes as intestate estate. The Colorado Supreme Court is here following the last rule, the so-called Massachusetts rule.[13]

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[8] MacMurray v. Brown, 91 U.S. 265 (1876).
[9] Logan v. Small, 43 Mo. 254 (1861).
[10] Citizens Rwy. Co. v. Foxley, 107 Pa. St. 539 (1884).
[11] Gibson v. Hills, 84 Colo. 596, 272 P. 660 (1928).
[12] Hickey v. Costello, 80 Colo. 461, 251 P. 595 (1927). Roe v. Kavanaugh, 81 Colo. 152, 154, 254 P. 161 (1927).
[13] Worcester Trust Co. v. Turner, 210 Mass. 115, 96 N.E. 132 (1911).

The question as to the disposition of the residuary legacy is a close one. The general rule says the gift will go as intestate estate where one of the residuary legatees cannot take his share due to his prior death. It is significant in this case that the gift was to the three named legatees, "share and share alike." This shows a desire on the part of the testator that each one of the legatees take one-third of the residue rather than a share in the residue as a member of a class. Following this view the Supreme Court determined that the residuary legacy to Bridget Feeney went as intestate estate to be distributed under the law of descent and distribution.

The contrary view, followed in the courts of only two states,[14] holds that to allow the gift to go as intestate estate is contrary to the policy of effectuating the intent of the testator. This view furthers itself in the logic that a reduction in the number of legatees does not effect the force of the grounds upon which a lapsed legacy falls into the residuum, and if the rule is applicable to one, it should be applicable to both general and residuary legacies.

AUTHORITY CONTRA TESTATOR'S INTENT?

It is clear that the decision in *Feeney v. Mahoney* follows the great weight of authority. The decision is in accord with a New York case[15] decided in the same month. The New York court held a lapsed residuary legacy would not further lapse into the residuum but went on to say that "the rule is not one of strongly prevailing type and yields readily to any fairly tenable indication that a testamentary intent may be derived and established from some intimation of a secondary or standby residuary provision."[16] In the Colorado case there seems to be no secondary provision as evidenced by the will. Therefore the cases are in apposition.

In rendering the decision in *Feeney v. Mahoney* the Supreme Court ruled the amendments to the statute did not affect the case. The court went on to declare that the prevailing common law rules governed the disposition of the legacies. The effect was to prevent the heirs of Bridget Feeney from gaining any benefit which might have accrued to them by the will. The other legatees received a larger sum than that intended by the testator. Still another result was to take from the testator the right to designate the disposition of that part of the estate declared intestate. However, since there was no alternative put forth by the will, that part of the estate had to go without the will. It is plain that the intent of the testator as expressed by the will could not be followed since the circumstances under which the will was written had changed.

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[14] Corbett v. Skaggs, 111 Kan. 380, 207 P. 819 (1922); West v. West, 89 Ind. 529 (1883).

[15] In Re Bowman's Will, 97 N.Y.S. 478 (May, 1950).

[16] *Ibid*, p. 481.

THE 1951 AMENDMENTS TO THE RELINQUISHMENT AND ADOPTION LAWS

PHILIP B. GILLIAM
Judge of the Denver Juvenile and Family Court

Changes in the relinquishment and adoption laws of Colorado were enacted by the 1951 General Assembly in response to widespread demands by the public and child welfare organizations. Illegal relinquishments and a rising *black market* traffic in babies throughout the country is cause for close scrutiny of the safeguards provided in our laws against such abuses.

Colorado is one of the first states to put through curative amendments, and our success was due in large part to broad nonpartisan support, and the recommendations received by the Juvenile Court from the State Home for Dependent Children, Catholic Charities, Children's Aid Society, Child Welfare Division of the Bureau of Public Welfare, the Jewish Child and Family Welfare Service, and from various members of the Denver and Colorado Bar Associations.

RELINQUISHMENTS—H. B. 219

House Bill No. 219, designed to put an end to the illegal traffic of selling babies, or making changes in their custody outside of official channels, *black market babies,* was sponsored by Representatives Wade and Carter, and Senators Gambill, Henry, Cheever, Bennett and Davis.

Section 1 of H. B. 219 amends Section 3, Chapter 129, Session Laws of 1949, the *Jurisdiction and Venue* section, by adding a penalty for violation, making it a misdemeanor punishable by fine or imprisonment, or both, for any relinquishment not in accordance with statutory provisions. Parents relinquishing a child and persons receiving a child for adoption are covered by the added language. Excluded from the new penalty provision are those cases where the relinquishment is to "step-parents, grandparent or grandparents, uncle or aunt of said child." Any juvenile or county court, other than a county court in a county wherein a juvenile court is functioning, shall have jurisdiction of all relinquishment petitions.

The penalty clause reads:

> Any person who shall violate the provisions of this section shall be guilty of a misdemeanor, and upon conviction thereof, shall be fined a sum of money not exceeding Five Hundred Dollars ($500.00), or imprisoned for a period not exceeding six months, or both such fine and imprisonment.

ADOPTIONS—H. B. 220

House Bill No. 220, sponsored by Representatives Wade and Pellett and Senators Bennett, Cheever and Davis, contains amendments to seven sections of Chapter 106, Session Laws of 1949.

Section 1, amending subsections (2) (b) and (2) (g) of Section 6, *Consent to Adoption,* provides for an exception to the necessity for obtaining consent to proposed adoption from both natural parents in the case of a child born out of wedlock. An additional exception to the necessity for obtaining consent of both natural parents to proposed adoption is made in those cases, where without cause, there has been failure to provide reasonable support for a child for one year or more. It is now provided that consent of the Superintendent of the State Home for Dependent and Neglected Children will be proper consent for the adoption of any child in the care, custody and control of the State Home for Dependent and Neglected Children. This is an alternative provision to consent by the Board of Control of such institution.

Section 2, amending subsection (1) of Section 7 of the 1949 law on *Hearing and Examination,* provides that where the child has been in an adoption home under supervision of a duly licensed child placement agency, the State Home for Dependent and Neglected Children, or any public welfare department, the court may hear the petition for adoption forthwith and grant the adoption decree (as formerly, this also pertains to a child who is a grandchild or stepchild of one of the petitioners). Otherwise, a 30 day waiting period is required between filing of petition and hearing of the adoption petition and examining of interested parties.

Section 3, amending Section 8, *Notice of Hearing,* requires notice of pending proceedings on adoption, in case of a child not a grandchild or stepchild of petitioner or petitioners, to any interested person or agency, unless such person or agency has already consented, and adds the requirement of notice to the adoptive child if over twelve years of age.

Subsections (1) (d) and (2) of Section 9, *Hearing on the Petition,* are amended by Section 4. If, in the discretion of the court, it will serve the best interests of the child, a forthwith decree on the findings may be entered and a final decree of adoption be granted. The former provision for an interlocutory decree to become final at the end of one year is maintained in the amended bill.

The wording under subsection (2) is changed to *any waiting period* in place of the former *such,* to encompass the court's discretionary powers regarding the *forthwith* or *interlocutory decrees.* This change is also made under Section 5, amending Section 10, *Final Decree of Adoption.*

A clause is added by Section 6, amending subsection (2) of Section 11, *Legal Effects of Final Decree of Adoption,* protecting the legal rights or obligations of the natural parent from being divested in those adoptions where the adopting parent is a step-parent married to a natural parent.

Under Section 7, amending Section 15, *Records,* adoption records and papers will be considered *confidential records of the court,* striking the former provision for *sealing,* and such records shall not be *open to public inspection unless by order of court.* A provision also is added by this section that only one docket fee will be assessed in cases involving more than one child.

THE RETAIL MOTOR VEHICLE INSTALLMENT SALES ACT

LOUIS A. HELLERSTEIN
of the Denver Bar

By the enactment of the "Retail Motor Vehicle Installment Sales Act"[1] Colorado became the eleventh state to enact specific legislation covering the installment sale of motor vehicles. The act, which becomes effective on July 1, 1951, is restricted to *installment sales* of such type of personal property. It does not affect nor legislate upon cash sales nor does it affect installment retail sales of any articles of personal property except *motor vehicles* as defined in the act. Transactions other than retail sales are not affected by the act.

The act covers those engaged in the sale of motor vehicles upon the installment plan and financing institutions who purchase or lend upon contracts resulting from such sales and make collection thereon such as banks, finance and loan companies. An individual selling his car is not affected by the act nor are those banks or finance and loan companies who make loans upon the collateral of such contracts or purchase such contracts, but who do not (prior to default of the seller or borrower) collect the payments upon such contracts.

Motor vehicles generally as covered by the act are passenger cars, trucks, station wagons and motorcycles. Road machinery, tractors and agricultural machinery of a similar nature are excepted from the provisions of the act.

If a sale of a motor vehicle upon an installment basis is involved the act applies even though the form of contract purports to be a leasing or bailment when the bailee or lessee contracts to pay as compensation for its use a sum substantially equivalent to the value of the property and bailee or lessee is bound or has the option of becoming the owner thereof.

A finance company or a bank which makes a direct loan to a purchaser to finance the purchase of a motor vehicle is not subject

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[1] H.B. 332, approved April 12, 1951, Holland's Legislative Service, p. 448.

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A finance company or a bank which makes a direct loan to a purchaser to finance the purchase of a motor vehicle is not subject

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to the act. In such a case neither is the installment sales contract subject to the act.

The act purports to accomplish the following four principal objectives:

1. *Full disclosure of terms of sale and costs.*
2. *Mandatory provisions for rebate of part of the "time price differential" upon prepayment.*
3. *The limiting of delinquency and collection charges.*
4. *General provisions safeguarding the rights of installment purchasers of motor vehicles.*

Rates, discounts, charges or reserves are not regulated.

LICENSING PROVISIONS

Individuals, partnerships, corporations, and associations or other operating organizations, exclusive of banks, trust companies and industrial banks, who (1) act as principal or broker in the acquiring of retail installment paper from the seller or lend thereon *and* make the collections upon such contracts from purchasers, and (2) those motor vehicle dealers who retain their own contracts of sale are designated as a "Sales Finance Company" and are required to be licensed under the act. A sales finance company, which makes loans upon such installment contracts or buys such contracts in bulk and does not, in the absence of default by the seller or pledgor, collect the payments, is exempt from being licensed. As stated, banks, trust companies and industrial banks even though they act as sales finance companies and buy contracts or lend upon contracts and make collections thereon are not required to be licensed.

Companies making *direct loans* to finance the purchase of motor vehicles are not required to be licensed.

Motor vehicle dealers who sell their contracts are subject to the terms of the act but are not required to be licensed. Motor Vehicle dealers who retain their contracts are required to be licensed as a "Sales Finance Company".

Applications for licenses are filed with the State Bank Commissioner. No convenience or advantage clause is contained in the act and licenses are automatically issued upon payment of the fee required and the filing of the application. The license for the calendar year or any part thereof is $100 for the principal office in the state and $25 for each branch office. All licenses expire December 31st of each year. Changes of locations are endorsed without charge.

The Bank Commissioner is given power to suspend or revoke licenses for various causes after due notice and a hearing. The principal grounds for revocation or suspension are (1) failure to comply with the act; (2) defrauding a buyer; (3) failure to comply with a written agreement with the buyer; or (4) fraudulent misrepresentation, circumvention or concealment by any subterfuge or device of material matters required to be stated in a sales contract.

It is made a misdemeanor to operate as a "Sales Finance Company" without procuring a license as required by the act.

THE SALES CONTRACT

The act requires the seller and purchaser to enter into a written contract for the retail sale and purchase of a motor vehicle upon an installment plan basis. Such contract must contain all the agreements of the parties, must be signed by the buyer and a copy furnished the buyer at the time of the execution of the contract. The execution of a sales contract in blank is prohibited except that serial numbers or other identifying marks which are not available at the time of its execution may be inserted later.

Each such installment sales contract is required to contain the following numbered items and in the following order:

1. The price of the motor vehicle which is the subject matter of the retail installment contract if the sale were made for cash;
2. The amount of the retail buyer's down payment, stated separately;
   (a) The amount of any cash payment; and
   (b) The amount of goods given in payment, if any;
3. The unpaid balance of the cash price, which is the difference between items (1) and (2);
4. The cost to the retail buyer of any insurance and any option of benefits included in the transaction, specifying the types of coverage and benefits;
5. The amount of the time price differential;
6. The time balance owed by the retail buyer to the retail seller and the number of installment payments required and the amount and date of each payment necessary finally to pay the time balance, which is the sum of items (3), (4), and (5). The amount of items (4) and (5) may be added together and stated as one sum in the contract, and if so stated, the retail seller or his assignee shall, within thirty (30) days after the making of the retail installment contract, mail or cause to be mailed to the retail buyer at his address as shown on such contract, a statement reciting separately the amount of item (4) and the amount of item (5).
7. The time selling price of the motor vehicle, which is the sum of items (2) and (6).

The above numbered items may be set out in the sales contract or in the mortgage, if desired, or, the contract may be recited in the purchase order while the conditions as to the retention of the lien or mortgage may be set out in a note and chattel mortgage as separate instruments. Many sellers prefer to use a chattel mortgage when making an installment sale which recites the full terms of the sale as well as the mortgaging or retaining of a lien to secure the balance of the purchase price.

The duty of entering into the required written sales contract and compliance with the provisions of the act relative thereto devolves upon the vendor of the motor vehicle. It is not an obligation of the purchaser or pledgee of such contracts to ascertain that a proper contract is entered into by the seller and buyer; nor is the validity of a note and mortgage affected by failure of the seller to enter into the type of sales contract provided by the act.

If chattel mortgage instruments or other lien instruments are used, full compliance with the chattel mortgage is still necessary. The installment Sales Act does not vary or change the Colorado Chattel Mortgage Act.

Collection and Delinquency Charges

Within the limitations set out in the act, collection charges or delinquent charges are permitted. To be collectible appropriate provisions covering the right to collect delinquent charges or collection expense or attorneys' fees should be contained in the note and mortgage or contract.

The following delinquency charges or collection expenses are permitted by the act:

(a) *5% of the installments in default or $5.00 whichever is a lesser amount when such default has continued for a period of at least ten days.*

(b) *An attorney fee not exceeding 15% of the amount due when the collection is handled by an attorney who is not a salaried employee of the holder of the contract, note or mortgage.*

Unless delinquency has continued for at least a ten day period, collection charges are not permitted. Also, interest upon delinquent installments is not permitted in view of the delinquency charges provided for by the act.

The attorneys' fees permitted are *in addition* to the delinquency and collection charges permitted.

Refund Upon Prepayment

Since most installment sales contracts contain a finance charge or a "time sale differential" (added to the cash sales price) based upon the period of payment, the act provides for a refund for prepayment. The refund formula set out in the act is what has commonly become known as the "Rule of 78ths". Prior to making such computation of a refund, the holder of the contract is permitted to deduct and retain $15 as the acquisition cost of the contract.

A buyer has *the privilege of prepayment at any time.* Regardless of the terms of the written instruments, as a matter of law, prepayment in full by the buyer may be made at any time. If the refund is less than $1.00 none need be made.

The buyer may also elect to cancel the insurance written in connection with the loan and receive cancellation of the unearned premium upon a short rate basis.

PROVISIONS FOR BUYER'S PROTECTION

Insurance—If insurance is included in the retail sales installment contract, within 30 days after the date of execution of such contract, the seller or holder of the contract or mortgage is required to send or cause to be sent to the buyer a policy or policies of insurance or certificate of insurance showing the amount of the premium, the kind of insurance, scope of coverage and the terms, conditions, exemptions and limitations of the contract of insurance.

Insurance can only be written by insurance companies authorized to do business in Colorado.

Statement of Time Price Differential and Insurance—In the event the original sales contract contains a combined figure showing the amount of the time price differential and insurance as one item, then within 30 days from the date of the contract, a statement showing separately the cost of the insurance and the time price differential is to be furnished the buyer.

Confession Judgments—In connection with retail installment sales of motor vehicles no provision for confession of judgment is valid or enforceable.

Complaints—A buyer, having a complaint with reference to his retail installment contract may file the same in writing with the Bank Commissioner. When the Commissioner receives such written complaint, he is authorized to inspect the instruments relating to the transaction complained of.

The act gives the Commissioner the right to issue subpoenas, compel the attendance of witnesses, administer oaths and generally supervise operations under the act. It is presumed that a complaint found to be justified could result in the Commissioner exercising his right to suspend or revoke a license.

The act also provides for the enforcement of subpoenas through Court action if a witness refuses to appear and testify.

Payment of Contract—If a contract of sale or mortgage and note is assigned and no notice is given to obligor thereof, a buyer making payment to the seller or payee named therein, is protected. To protect himself, an assignee should give notice of the assignment to the buyer of actual or intended assignment. The act, however, does not require mandatory notice of assignment of such contracts or notes and mortgages evidencing the balance of such purchase price of the motor vehicle.

Rate Charts—Every Sales Finance Company is required to keep on file with the Commissioner the maximum rate chart or charts in use and numbered for identification.

The "Retail Motor Vehicle Installment Act" is a new experiment in the field of installment sales which has had such a tremendous growth in our country; it fills a need in our state to safeguard the interest of buyers of motor vehicles. It may be necessary in the future to pass legislation covering other fields of installment sales.

The act is a forward step in the interests of the public, founded upon a need that has developed toward legislation of this character. It will be of interest to watch the developments that occur and thereafter determine the need, if any, of any such amendments to make the act and its purposes adequate and effective.

YOUR SPECIAL DISABILITY INSURANCE AND MILITARY SERVICE

In view of the still-pending threat of military service for many members of the association, those who carry the Special Disability Insurance of the Commercial Casualty Insurance Company via the Udry Agency, Denver, will be interested in the following statement of policy from the company:

"The primary purpose of our Special Disability Insurance Plan is to furnish income protection during the period that you are physically unable to perform your usual civilian, professional duties.

It is our understanding that if you enter military or naval service the Government will see that in the event of a disability—

1. Your income will continue.
2. You will be provided with hospitalization and medical care.
3. That National Service Insurance is available to you at exceptionally low rates.

Therefore, should you enter Military or Naval Service, we will arrange to place the coverage provided under this plan in suspense on the following basis:

A. By returning the unearned premium on a pro-rata basis, and

B. Granting you the privilege of applying for *automatic reinstatement* when you are discharged from military or naval service, provided written application for reinstatement is made within forty days after you have resumed the regular duties of your profession.

C. When your Special Disability Policy is reinstated, there will be no back premiums or arrears to pay. Your reinstatement premium will be pro-rated to the next renewal date of the other members of your Society."

CURRENT DEVELOPMENTS IN TAXATION

BY ALBERT J. GOULD AND KENNETH L. SMITH
of the Denver Bar

EXCESS PROFIT TAX DISTRIBUTIONS

No distribution of capital nor of earnings by a corporation subject to excess profit taxes should be made within the first sixty days of the taxable year because such distribution may affect the computation of the increase or decrease in equity capital.

DEPRECIATION—WHEN DEDUCTIBLE

Section 23 (1) was amended by the 1942 Act to allow a deduction for depreciation of property held by the taxpayer for the production of income, regardless of whether the property is actually used in the trade or business of the taxpayer.

Although the former law, restricting the deduction to "property used in the trade or business" has always been interpreted by the Bureau to allow depreciation on any building from which the taxpayer-owner received rent, the amended law makes it clear that all property "held for the production of income" is depreciable, even before actual use *and the deduction is not conditional upon receipt or accrual of income from the property in the taxable year.*

The above provision is important as to investment property. The capital gain period of six months clearly starts to run from the time the property becomes subject to depreciation. See *Dougherty Co. v. Commissioner,* 159 F. (2d) 269, 35 A.F.T.R. 669, and cases cited therein.

STOCKHOLDERS' ADDITIONAL CORPORATE TAX

If a corporation has been liquidated in full, all assets have been distributed, and stockholders, as transferees, are required to pay corporation tax deficiencies, the payment by each stockholder is deductible *in full. Switlik,* 13 T.C. 121, affirmed. The foregoing applies only if the corporate tax liability was unknown at liquidation. In liquidating a corporation therefore, it can be desirable to distribute all assets rather than to withhold some assets for the purpose of paying taxes until the statute of limitaions has run. The determination of this question will depend upon the responsibility of all stockholders.

Real Property Capital Gain

Because there seems to be confusion as to when the sale of real property is a capital gain, we restate a few rules:

1. Property held for sale to customers in the ordinary course of business is an ordinary asset and the gain is taxable in full. The danger in this rule lies in the fact that one not primarily in the business of buying and selling real estate can find himself in the position of holding property primarily for sale to customers within the above rule, if he buys and sells several parcels within a short period of time, or if he buys unimproved property merely for the purpose of resale at a profit, or if he subdivides unimproved property and sells the same in lots from time to time, or if he buys and sells apartment houses or any other definite class of real property as a side line but more or less frequently over a period of years.

The determination of the above controversial proposition approaches a twilight zone and lawyers should be careful to caution clients regarding the foregoing, particularly those who are purchasing tracts of land for resale at a profit in the current real estate boom.